



RULES PROCESSING TEAM

May 27, 2003

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Mr. Marshall Rose
Chief, Economics Division
Minerals Management Service
381 Elden Street, Mail Stop 4024
Herndon, VA 20170-4817

Attention: Rules Processing Team (Comments)

Via email and facsimile

**Industry Comments on Minerals Management Service Proposed Rule
Regarding Relief or Reduction of Royalty Rates—Deep Gas Provisions;
68 Federal Register 14868-14886 (March 26, 2003)**

Dear Mr. Rose:

The American Petroleum Institute (API), Domestic Petroleum Council (DPC), Independent Petroleum Association of America (IPAA), and the US Oil and Gas Association (USOGA) welcome the opportunity to comment to the Minerals Management Service (MMS) on the agency's proposed rulemaking regarding the reduction of royalties for existing leases located in the shallow water of the Gulf of Mexico associated with deep gas drilling. These four associations represent hundreds of energy companies engaged in all aspects of the offshore oil and natural gas industry, including the majority of companies that hold most of the oil and gas leases found in the shallow federal waters of the Gulf of Mexico.

Industry supports the concept of royalty relief to encourage exploration and development of potential deep gas resources underlying shallow water leases and considers implementation of the proposed rule to be an important step that will help keep domestic oil and gas supplies flowing to consumers. Vertical frontiers at depths greater than 15,000 feet have been lightly explored and may offer substantial new resource potential—estimated to be between 5 and 20 TCF—or enough to heat 5-20 million American homes for 15 years. Improved seismic imaging and new drilling technologies allow these depths to be mapped; however, exploration and development still presents some risk for investors, especially if permit delays and other regulatory impediments increase project costs. The proposed rule would help stimulate production of natural gas from a promising existing area and it has the potential to bring about much-needed expansion of natural gas supply within five years or less.

Natural gas remains an essential fuel for sustaining economic growth, currently supplying about one-fourth of the nation's energy needs. According to the Energy Information Administration (EIA), natural gas demand is expected to grow by more than 50 percent by 2025. New demands

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for electricity generation are expected to account for more than half of this expected growth. Although about 80 percent of the domestic natural gas produced from the Federal waters of the Gulf of Mexico comes from leases in shallow waters (less than 200 meters), production from this area has declined sharply in the past few years. Areas off the Atlantic and Pacific coasts as well as most of the Eastern Gulf remain off limits to development.

To assist MMS in evaluating these comments, we have organized them into two parts: 1.) the general comments address eight broad categories: adequacy of the royalty suspension volumes, investor confidence, threshold price, treatment of sidetracks, unitization, the use of auctions, definition of qualifying leases and deep wells, and the five-year time limit, and 2.) modifications to the proposed rule that would implement suggestions described in the comments. Not all of the questions posed by MMS can be answered since some require proprietary information and/or an individual company response.

We look forward to a dialogue with MMS to ensure that this rule is effective in stimulating the development of this promising frontier. Please direct any inquiries to Ms Linda Bauch, API (202-682-8170).

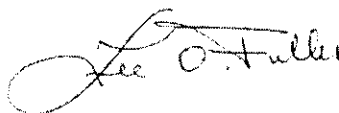
Sincerely,



American Petroleum Institute



Domestic Petroleum Council



Independent Petroleum Association
of America



US Oil & Gas Association

Attachment (1)

**Comments on the MMS Proposed Rulemaking on
Relief or Reduction of Royalty Rates—Deep Gas Provisions
68 FR 18468 (March 26, 2003)**

by

**The American Petroleum Institute (API), the Domestic Petroleum
Council (DPC), the Independent Petroleum Association of America
(IPAA), and the US Oil and Gas Association (USOGA)**

Introduction: Rising natural gas demand

Natural gas is an essential fuel for sustaining economic growth, currently supplying about a fourth of the energy used in the U.S. Natural gas has several key advantages relative to other competing fuels. It is cleaner burning, producing virtually no sulfur dioxide or particulates, and far lower levels of carbon and Nitrogen oxide than coal or oil. It is an extremely efficient energy source, delivering a higher ratio of energy output to energy input than competing fuels. It is a secure source of energy, with sufficient quantities available from North America to satisfy demand. U.S. natural gas use is already expanding rapidly, and is expected to expand even more rapidly over the next two decades. Since 1985, U.S. gas use has expanded by about a fourth. According to the Energy Information Administration (EIA), natural gas demand is expected to grow by more than 50 percent by 2025. The key sector driving this growth is expected to be electricity generation, where the environmental and economic advantages of combined cycle gas generation have made gas the fuel of choice for 98% of the electrical capacity additions planned over the next five years. New demands for electricity generation account for more than half of the expected growth in U.S. gas demand over the next two decades.

We believe that this rule is a positive step in stimulating the supply volumes that will be needed to fuel the required expansion in natural gas supply from a very promising existing area, and it offers the potential for doing so in the relatively near term. We look forward to a dialogue with MMS to ensure that this rule is effective in stimulating the development of this producing horizon.

Role of the Gulf of Mexico shelf

About a quarter of domestic natural gas is produced from the Federal waters of the Gulf of Mexico, with about 80% of this coming from leases in shallow water (less than 200 meters). But in recent years, production from this area has been in steep decline. Since the mid 1980s, annual gas production has exceeded reserve additions each year, causing a dramatic decline in both reserves and production capacity from the Gulf. Proved reserves in the Gulf declined from about 46 TCF in 1986 to about 24 TCF in 1999. The declines have been sharpest in the shallow water, where production has fallen from 4.8 TCF in 1996 to an estimated 3.3 in 2002, a decline of over 31% in just 6 years.

Reversing this decline will require the tapping of new frontier areas. But many of these potential frontiers (Atlantic, Pacific, and Eastern Gulf) are off limits to development. Other major frontier areas which are currently available, such as the deep and ultradeep waters of the Central and Western Gulf, offer significant resource potential, but generally are expected to offer their major contributions to supply only after long lead times. On the other hand, vertical frontiers, at depths below those exploited traditionally on the shelf, may offer substantial new potential than what is currently available. Deep areas beneath the shelf, at depths greater than 15,000 feet, are relatively lightly explored—only 5% of the wells drilled in the Gulf have extended below 15,000 feet. Improved seismic imaging and drilling technology make mapping at these depths possible still present risks for investors. (Drilling costs range from \$10 to 60 million per well; success rates are lower although discovery sizes are larger.) Because of high cost and risk, relatively few of these wells are currently being drilled—between 32 and 94 wells per year since the mid 1980s—despite the fact that the area is estimated to contain significant resource potential (5 to 20 TCF).

Proposed incentives complement those already in place

The dual problems of high cost and high risk make deep gas drilling a candidate for financial incentives. The relevant question for policy is whether the benefits associated with the incremental supply induced by those incentives exceed or fall short of the revenues foregone by government in providing those incentives. According to MMS's calculations, the value associated with the new supply under the proposed rule far exceeds any royalty foregone by that rule.

MMS has already used its authority for royalty relief under authority of the Deepwater Royalty Relief Act of 1995 to attempt to stimulate supply from this new Gulf of Mexico frontier with financial incentives. Royalty relief has been offered for deep gas on new shallow water leases since 2000. However, these incentives cover only a small portion of the estimated deep gas resource base. The proposed rule serves to complete the coverage of incentives by extending it to deep wells on existing leases, where both the bulk of the resource and the bulk of existing infrastructure occur. The size of the resource combined with the ready access to existing infrastructure makes these deep gas resources one of the most attractive potential sources of new supply within five years or less.

The proposed rule

Under the proposed rule, any GOM lease issued in a sale prior to January 1, 2001, wholly west of 87 degrees 30 minutes west longitude and wholly in water depths less than 200 meters which has not produced from a well 15,000 feet or deeper could qualify for royalty suspension volumes or supplements. A well between 15,000 to 18,000 feet deep, if successful, would qualify that lease for 15 BCF in suspension volume. For a successful well greater than 18,000 feet, the lease would receive a 25 BCF suspension volume, while an unsuccessful well at depths greater than 18,000 feet would earn the lease a 5 BCF suspension supplement. A lease could earn up to two suspension supplements plus

the suspension volume associated with the first successful deep well, implying a maximum of 35 BCF royalty-free production per qualified lease.

The benefits of the proposed rule are limited in a number of ways, however. First, the lease only qualifies for relief if gas production from the completed deep well commences within five years of the effective date of the rule. Second, in any year in which price exceeds \$5/mmbtu (in 2000 dollars, adjusted for inflation), lessees would be required to pay royalties on production, even though that production would be counted toward the eligible suspension volumes and/or supplements on that lease. Third, the royalty suspensions proposed apply only to new wells not sidetracks. Fourth, while not part of the current rulemaking, MMS is soliciting comments on alternative mechanisms to allocate royalty relief on existing leases in the future, such as auctions based on the amount of royalty relief (with relief given to the low bidder).

General comments

MMS requested comments on the proposed rule along with comments concerning various questions described in the preamble of the proposed rule. To assist MMS in evaluating these comments, we organized them into two parts: 1.) the general comments address eight broad categories: adequacy of the royalty suspension volumes, investor confidence, threshold price, treatment of sidetracks, unitization, use of auctions, definition of qualifying leases and deep wells, and the five year time limit, and 2.) modifications to the proposed rule that would implement suggestions described in the general comments. Not all questions posed by MMS can be answered in the comments since some questions require proprietary information and/or an individual company response.

Adequacy of the Royalty Suspension Volumes. Royalty relief incentive volumes that will cause an increase in drilling activity are difficult to determine. Average field size distributions in shallow waters of the Gulf of Mexico, geological proposed type, size and risk, drilling challenges and product pricing are all factors in the decision process to drill or not. The incentive volumes proposed by MMS are considered reasonable and are of an amount sufficient to positively impact the decisions being contemplated by lessees to drill deep gas prospects. Larger or smaller volumetric incentives could be expected to have larger or smaller effects respectively, on the level of a lessee's investment. Since each prospect is unique, quantifying a generic suspension volume that would apply to most drilling decisions is difficult and we believe the approach and amount of royalty suspension volume proposed by MMS is adequate.

Investor Confidence. Perhaps one of the most essential elements of a program of royalty relief is its ability to inspire confidence in potential investors that the incentive promised by the relief will in fact be realized. The recently adopted program of royalty relief for deep gas from new shelf leases provides a good model of a simple approach that fosters certainty. The clarity and simplicity of the proposed rule builds on this example and MMS is to be commended for avoiding complex discretionary tests that would undermine the effectiveness of the proposed incentives.

Threshold Prices. Perhaps the most significant departure of the proposed rule from this principle of simplicity is that of the threshold price. If price rises above some arbitrary threshold (e.g., \$5 per mmbtu) the producer loses the relief. Given that recent prices are already in excess of \$5 per mmbtu, this provision generates uncertainty as to whether any royalty relief will actually be granted. On the other hand, if a price threshold is necessary, counting only the volumes produced when prices are actually below the threshold against the royalty suspension volume and supplements could reduce the amount of uncertainty to potential investors.

Sidetracks. Sidetracking existing well bores is a very common practice followed in the Gulf of Mexico. With approximately 3,500 platforms in existence, the likelihood of utilizing a previously drilled well bores to drill new deep tests is high. There are many cases where the existing well bore design will not allow the efficient or effective sidetracking to a deep geological target; however, there are other situations where an existing well bore could be utilized. MMS should encourage, not discourage, the use of existing wells to drill, develop and produce deep gas opportunities, for several of reasons, including:

- Conservation and efficient use of existing infrastructure—the existing wellbore can be utilized in some cases and it does not require a complete redrill.
- Environmental Reasons—using the same wellbore for a portion of the deep well results in less air emission from a rig during the drilling operation and less discharges of drilling mud and cuttings.
- Safer Operation—by drilling from a kick-off point deeper in the well the operator may avoid drilling through depleted zones that can cause difficulties and well control problems.
- Limited Slot Platforms—many shelf platforms have all slots fully utilized and can not handle additional well slots without structural modifications (which in many cases are not possible or very expensive) so the reuse of existing well slots is a must that may encourage operators to drill new deep wells if the incentive is available to them.

Additionally, new technology such as expandable tubulars allows the safe re-use of portions of existing wells but at a premium cost, due to the use of advanced technology.

The primary purpose of this proposed rule is to encourage deep drilling on the shelf. By eliminating sidetracking operations, MMS is excluding one of the most viable technological options for exploring deeper for new gas reserves in the most economic manner possible, by exploiting the existence of existing infrastructure. One of the principal reservations that MMS expressed as a reason not to include sidetracks was the limitation of published API drilling cost data on sidetracks. API would be glad to discuss with MMS the possibility of developing more extensive information from unpublished data if this would enhance the prospect of including sidetracks in the program.

Unitization. If the purpose of this proposed rule is to stimulate deep gas drilling in the Gulf, drilling the best opportunities sooner rather than later would be preferable. Under any unit scenario the objective is to drill and develop common geological features that underlie multiple leases. To eliminate unnecessary drilling, the best drilling locations in

a unit are selected and drilled. Drilling unnecessary wells is reduced, if not eliminated. Under the proposed rule, an argument can be made that MMS is promoting the drilling of unnecessary wells to preserve royalty relief for all leases in a unit. As an example, if a four-lease unit exists with a recognized undrilled deep (20,000') prospect, the unit owners would pursue drilling this deep prospect from the best surface location to reach the bottom hole objective. Should the well be successful and qualify for royalty relief, only the lease where the well is completed would actually receive any royalty relief. Until the other three leases in the unit were drilled, they would not be entitled to any royalty-free production on any portion of their allocated share of production.

This omission gives rise to two possible outcomes, each involving an unintended consequence. In the first case, unit owners would recognize—prior to drilling—that the MMS royalty incentive would be reduced, thus reducing the overall incentive to drill the original qualifying well. For example, under the proposed rule, if two leases were combined on a 50/50 basis to form a unit to test a prospect at 17,000' and it is anticipated that only one well would be necessary, the unit owners would conclude that the benefits of royalty relief would only be half what they would be under the same rule without the unit agreement. Thus the intended incentive on drilling the first well would be diluted and the royalty relief would not be shared equitably.

The second case would occur if, notwithstanding the above, the first qualifying well is drilled. Then, the lessees are encouraged to drill further, unnecessary, wells to earn royalty relief. It is anticipated deep gas wells will encounter geological pressures that would allow large geographic areas to be drained, assuming reservoir sands are contiguous. If high pressures were encountered, only a few wells would be necessary to efficiently drain the reservoir. If those wells were drilled on only two of the four leases in the unit—assuming those wells were qualified deep wells—the undrilled leases in the unit would not be entitled to royalty-free production on production allocated to them.

The solution to this problem is twofold. First, MMS should consider allowing royalty suspension volumes to be granted to all undrilled leases in a unit once it becomes apparent that, for the prevention of waste and the conservation of the natural resources, a limited number of wells is necessary to develop a new deep gas discovery. We have suggested language in the proposed rule to address this issue and allow a mechanism for MMS to grant royalty relief on undrilled leases in a unit. This approach should not substantially increase MMS' administrative requirements. Second, in any unit, the suspension volumes should be allocated in proportion to the royalty obligations in the unit agreement.

Auction. While not a part of the current proposed rule, the notion of auctions is raised in MMS's questions, for possible inclusion in future rulemaking. Industry has strong concerns with this issue because it offers the greatest potential for undermining the intent of the proposed relief provisions. Applying royalty incentives to all leases and lessees is a fair and non-discriminatory way of encouraging drilling in the OCS. Implementing an auction method of allocating incentives would eliminate certain lessees from being able to compete for the incentives and ultimately could result in fewer wells being drilled.

Under an auction procedure, firms would bid for royalty relief, either through cash bonus bidding or with the royalty relief itself as the bid variable. Industry strongly opposes such a provision, as it would be prone to unintended and perverse consequences. Most importantly, the auction mechanism would defeat the purpose of the rule, denying relief to those that need it most and granting relief to those that need it the least, thereby undermining the purpose of the program by compromising the incentive to drill wells that would not otherwise be drilled.

Qualifying leases and deep wells. Industry offered several suggestions broadening slightly the categories of leases included in the program. First, the proposed rule would apply only to those leases issued in an OCS lease sale held before January 1, 2001. This should be clarified to include state leases issued prior to and subsequently ratified by the 1953 OCS Lands Act. Second, the qualifying leases should not be restricted to those entirely in waters less than 200 meters, but more broadly to leases, any portion of which is in water depths less than 200 meters. Third, as the intent of the proposed rule is to stimulate a rapid supply response, qualifying wells should not be limited to those spudded after the effective date of the rule. We suggest that any well on which an economic determination has not been made at the time the rule is implemented should be considered a potential candidate for royalty relief under the rule. Consequently, those wells that were being drilled when the rule was proposed should also be eligible.

Five year time limit. Industry suggests that the five-year window from the effective date of the rule is not long enough to explore, appraise, and establish production of deep reserves, given the technological challenges that such production will require. This is a key consideration when the high temperatures and high pressures found in reservoirs below 15,000' are considered. Rather than requiring an operator to bring production on line under an inflexible deadline based on shallow hydrocarbon technology, it would be preferable to ensure that the operator has adequate time to properly design the facility and well completion. Failure to provide an operator with adequate time to develop and use the advanced new technology that would be required could result in operators forgoing shallow water deep gas opportunities. Industry urges MMS to include a provision in the final rule by which additional time to the five years is granted on a case-by-case basis for circumstances in which additional time is justified to safely develop and start production. Examples of the technical justification include: high temperatures and high pressures that require special wellheads, downhole tubulars and downhole equipment (packers, subsurface safety valves, etc.); composition of gas that may require special equipment or unusual metallurgy (H₂S, CO₂, etc.); the installation of new pipelines to move the different composition gas if not allowed to enter existing infrastructure pipelines.

Suggested changes to text of proposed Rule

Below are suggested modifications to the text of the proposed rule that MMS could use to implement the suggestions described above. New language is underscored, deletions are shown as strike-throughs, and explanatory notes are italicized.

PART 203 RELIEF OR REDUCTION IN ROYALTY RATES

1. The authority citation for part 203 continues to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 31 U.S.C. 9701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. Section 203.0 is revised by adding definitions for “deep well”, “new well,” “participating area”, “reservoir”, “royalty suspension supplement,” “sidetracking operations,” (*Note: New definition*) “successful qualified deep well,” and “unsuccessful certified well” in alphabetical order to read as follows:

§ 203.0 What definitions apply to this part?

* * * * *

Deep well means a well drilled and completed with a perforated interval, the top of which is at least 15,000 feet true vertical depth below the datum at mean sea level (TVD SS), or a well drilled and completed with a perforated interval the top of which is at least 18,000 feet TVD SS (*Note: Phrase added for clarification*), or a well drilled but not completed to a target reservoir deeper than 18,000 feet TVD SS.

* * * * *

New well means a new well bore ~~that results from drilling that does not utilize or an existing well bore where sidetracking operations for a deep well have been conducted.~~ (*Note: Language suggested would include sidetracking operations for royalty relief consideration. See previous comments.*)

* * * * *

Participating area means that part of the unit area that is reasonably proven by drilling and completion of producible wells, geological and geophysical information, and engineering data to be capable of producing hydrocarbons in paying quantities.

* * * * *

Reservoir means an underground accumulation of oil or natural gas or both characterized by a single pressure system and segregated from other such accumulations.

* * * * *

Royalty suspension supplement means a royalty suspension volume generated from drilling an unsuccessful certified well and applied to royalties due on future royalty-bearing natural gas and oil production on, or allocated to, the same lease.

* * * * *

Sidetracking operations means a new deep well utilizing, in part, a well bore, including but not limited to open slots or reclaimed slots on a platform, in existence prior to the drilling of the new deep well and located on or off the lease. (*Note: New definition to add sidetracking operations to the rule.*)

* * * * *

Successful qualified deep well means a new deep well completed on your lease:

(1) That is being drilled on March 26, 2003 or begins drilling after March 26, 2003, and

(2) That begins producing natural gas, including gas associated with oil production before [DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE

FINAL RULE] from a depth equal to or greater than 15,000 feet deep TVD SS. (Note: Added for clarity.

* * * * *

Unsuccessful certified well means a new well drilled on your lease:

- (1) In progress on March 26, 2003 or beginning after March 26, 2003,
- (2) Beginning before [DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE],
- (3) Beginning before your lease produces, excluding test production, (Note: Added for clarity and to eliminate any confusion regarding production associated with testing a well before actual commercial production commences.) from a successful qualified deep well;
- (4) To a depth of at least 18,000 feet true vertical depth below the datum at mean sea level (TVD SS);
- (5) That targeted a reservoir identified by lessee or his designee (Note: Places the burden on lessee to identify the target reservoir.) from seismic and related data deeper than 18,000 feet TVD SS; and
- (6) That fails to meet the producibility requirements of 30 CFR Part 250, subpart A, from depths equal to or greater than 18,000 feet TVD SS (Note: Added for clarity.) and does not produce, or that MMS agrees is not commercially producible from any depth equal to or greater than 18,000 feet TVD SS. (Note: Added for clarity.) (Any well producing from a reservoir 15,000 feet TVD SS or deeper is deemed a successful well, though not necessarily a successful qualified deep well. In addition, a well drilled to at least 18,000 feet TVD SS but completed only at a depth above 15,000 feet TVD SS will not disqualify the well from being classified as an unsuccessful certified well. (Note: Added for clarity and to assist in eliminating any confusion regarding when the royalty supplement would be applicable.)

* * * * *

3. A new undesignated heading and new §§ 203.40 through 203.48 are added to read as follows:

ROYALTY RELIEF FOR DRILLING DEEP GAS WELLS

§ 203.40 Which leases are eligible for royalty relief as a result of drilling deep wells?

Your lease may receive a royalty suspension volume under sections 203.41 through 203.43 and may receive a royalty suspension supplement under sections 203.44 through 203.46 if it:

- (a) Was issued in an OCS lease sale held before January 1, 2001, or in a lease sale held on or after that date and the lessee has exercised the option under § 203.48, or a lease validated under Section 6 of the Outer Continental Shelf Lands Act of 1953, as amended (Note: Added to include leases in the OCS not issued pursuant to a lease sale.);
- (b) Is located in the Gulf of Mexico, wholly west of 87 degrees, 30 minutes West longitude ~~entirely~~ any portion of which is located (Note: The word "entirely" was deleted, and the new phrase added to include all leases where any portion of the block is in water depths of 200 meters. Adding this language will allow a few additional leases in the Gulf of Mexico to be subject to potential royalty relief for deep gas drilling. We

consider this beneficial and should be included as part of the area being considered for incentives.) in water less than 200 meters deep; and

(c) Has not produced gas or oil, with the exception of test production, (Note: Added for clarity and to eliminate any confusion regarding production associated with testing a well before actual commercial production commences.) from a deep well that commenced drilling before March 26, 2003. Production before that date from a deep well on another lease on your unit does not make your lease ineligible for royalty relief.

§ 203.41 If I drill a successful qualified deep well, what royalty relief could I receive?

(a) Subject to the administrative requirements of § 203.43 and the price conditions in § 203.47, we will suspend royalties for the produced gas volumes, as reported in accordance with 30 CFR Part 216.53 (Oil and Gas Operations Report, Part A or OGOR-A), shown in the following table (in billions of cubic feet or BCF):

If you have a successful qualified deep well . . .	then, we suspend royalties on this volume of deep gas production from or allocated to your lease as prescribed in this section and § 203.42:
(1) From 15,000 to less than 18,000 feet TVD SS	15 BCF
(2) 18,000 feet TVD SS or deeper	25 BCF

(b)(1) The royalty suspension volume determined under paragraph (a) for the first successful qualified deep well on your lease establishes the total royalty suspension volume available for that lease. You will not receive an additional royalty suspension volume if you drill more successful qualified deep wells on your lease or if you later drill and complete a deeper well that would have qualified for a higher royalty suspension volume. For example, if you drill a successful qualified deep well to 16,000 feet TVD SS and later drill a second successful qualified deep well on the lease to 19,000 feet TVD SS, your total royalty suspension volume is limited to 15 BCF. If your lease is within an MMS-approved unit, see subparagraph (3) of this paragraph.

(2) After you receive a royalty suspension volume for your first successful qualified deep well, if you later begin production from another successful qualified deep well on the lease, or begin production from a well existing on the lease prior to the first successful qualified deep well, (Note: Language added to ensure all available well bores could be utilized to produce new gas.) you must notify MMS of that production under §203.43.

(3) This paragraph applies if your lease is within an MMS-approved unit.

(i) If the first successful qualified deep well on your lease is a well within a unit participating area, 100 percent of the royalty suspension volume available for that well under paragraph (1) of this subsection applies only to your allocated share of production from that well. No other lease in the unit is entitled to any of the royalty suspension volume under this section or §203.42, even though another lessee may be entitled to a share of the production from the successful qualified deep well on your lease. Your royalty suspension volume for the lease will not increase if your lease is entitled to an

allocated share of production under the unit agreement from another deep well either on your lease or another lease in the unit.

(ii) If the first successful qualified deep well located on your lease was not a unit well, and if your lease is entitled to an allocated share of production under an MMS-approved unit agreement from another deep well within the unit participating area either on your lease or on another lease, that allocated share of production will not increase the volume of royalty suspension you qualify for under this section based on the first successful qualified deep well on your lease.

(iii) If you do not have a successful qualified deep well located on your lease, then you are not entitled to any royalty suspension volume for production allocated to your lease under the unit agreement from a successful qualified deep well on another lease in the unit.

(iv) Notwithstanding the provisions stated above, when a successful qualified well has been drilled within a unit, MMS will have the discretion to grant royalty suspension volumes in amounts equal to the suspension volume stated in § 203.41 for each lease included in the unit after determining a successful qualified well is not necessary to be drilled on each lease in the unit to efficiently develop the discovered reservoir. Should the MMS exercise this discretionary authority, the provisions of § 203.40, 203.41 and 203.42 shall apply to each lease in the unit granted a royalty suspension volume. (Note: By adding this language to the proposed rule, MMS is given the discretionary authority to give all leases in a unit royalty relief without the necessity of drilling wells on each lease. Due to the fact many deep reservoirs contain high geological pressure fewer wells most likely will be needed to extract the recoverable hydrocarbons when reservoir sands are continuous. Maximizing recoverable reserves with the minimum number of wells drilled to prudent reservoir management. Requiring wells to be drilled on all leases in a unit to earn royalty relief promotes inefficient reservoir development.)

(c) Any royalty relief allowed under paragraph (a) of this section is in addition to any royalty suspension supplement for your lease under § 203.44 that results from a different well bore.

(d) You must pay minimum royalties in accordance with your lease terms notwithstanding any royalty suspension volumes allowed under paragraph (a) of this section.

§ 203.42 To which production do I apply the royalty suspension volume from drilling a successful qualified deep well on my lease?

(a) This paragraph applies to any lease that is not within an MMS-approved unit. Subject to the requirements of §§ 203.40, 203.41, 203.43, 203.44, and 203.47, beginning on the day date of your letter where *(Note: Added for clarification and to eliminate any confusion as to the day royalty suspension begins to apply.)* you provide MMS the notice required under § 203.43, you must apply the royalty suspension volume to production from all successful qualified deep wells, or those existing wells capable of producing from the deep gas reservoir(s) drilled prior to the successful qualified deep well being drilled (Note: This phrase has been added to cover the possibility of using existing well bores to participate in the extraction of newly discovered reserves found in new deep reservoirs. Some existing wells could be sidetracked to exploit a new reserve. The language is suggested to cover this contingency to not eliminate a viable option for

efficiently developing newly discovered reservoirs.), on your lease for which you have given notice. Apply the royalty suspension volume applicable to your lease to that production each month until you use all of your royalty suspension volume.

(b) This paragraph applies to any lease all or part of which is within an MMS-approved unit and that has at least one successful qualified deep well located on the lease. Subject to the requirements of §§ 203.40, 203.41, 203.43, 203.44, and 203.47, beginning on the day date of your letter where (Note: Added for clarification and to eliminate any confusion as to the day royalty suspension begins to apply.) that you provide MMS the notice required under § 203.43, you must apply the royalty suspension volume to your share of production from all successful qualified deep wells, or those existing wells capable of producing from the deep gas reservoir(s) drilled prior to the successful qualified deep well being drilled (Note: This phrase has been added to cover the possibility of using existing well bores to participate in the extraction of newly discovered reserves found in new deep reservoirs. Some existing wells could be sidetracked to exploit a new reserve. The language is suggested to cover this contingency to not eliminate a viable option for efficiently developing newly discovered reservoirs.), on your lease for which you have given notice, and to production volumes allocated to your lease from deep wells on other unit leases drilled after March 26, 2003. Apply the royalty suspension volume applicable to your lease to that production each month until you use all of your royalty suspension volume.

(c) Unused royalty suspension volume automatically (Note: Added for clarification and the let lessees know no action is require to transfer the unused volumes.) transfers to a successor lessee and expires with the lease.

(d) You may not apply the royalty suspension volume allowed under § 203.41;

(1) To production from a deep well drilled before March 26, 2003, unless the production is obtained after the drilling of a successful qualified deep well (Note: Consistent with the thought that an existing well not qualifying as a successful qualified deep well initially but subsequently able to produce from deep reservoir encountered in a successful qualified deep well drilled later on the lease.);

(2) To production from wells less than 15,000 feet TVD SS;

(3) To deep production from any other lease, except as provided in paragraph (b) of this section.

(e) You must begin paying royalties when the cumulative royalty-free production of gas from or allocated to your lease reaches the applicable royalty suspension volume allowed under § 203.41. For the month in which cumulative production reaches this royalty suspension volume, you owe royalties on the portion of gas production that exceeds the royalty suspension volume remaining at the beginning of that month.

(f) All liquid hydrocarbon volumes are subject to royalty. This includes condensate recovered at separation facilities without processing. If you sell your gas before it is processed, the royalty suspension volumes apply to the gas production reported on the OGOR-A. If your gas is processed before you sell it, the royalty suspension volumes apply only to residue gas generated after processing and not to any natural gas liquids.

§ 203.43 What administrative steps must I take to use the royalty suspension volume?

(a) You must provide written notification to the MMS Regional Supervisor for Production and Development of your intent to commence drilling operations on deep wells; and

(b) Within 30 days of commencement of production that qualifies for royalty suspension, you must:

(1) Notify the MMS Regional Supervisor for Production and Development that production has commenced; and

(2) Request confirmation of the size of the royalty suspension volume that applies to your lease.

(c) You must meet any special production measuring requirements that the Regional Supervisor for Production and Development has determined are necessary under 30 CFR 250, subpart L for royalty suspension volume. No special production metering requirements will be necessary for measuring a royalty suspension supplement (*Note: Added for clarification.*).

(d) If you commenced drilling a successful qualified deep well after March 26, 2003 and produced it before **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]**, you must provide the information required by paragraph (b) on or after **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]** and no later than **[INSERT THE DATE 30 DAYS AFTER THE EFFECTIVE DATE OF THE FINAL RULE]**.

(e) Should you fail to provide timely notice as provided under this § 203.43, MMS will have the discretion to deny your request for a royalty suspension volume. (*Note: Added to eliminate any confusion as to what would happen should a lessee fail to timely notify MMS of a pending deep gas well test.*)

§ 203.44 If I drill an unsuccessful certified well, what royalty relief could I receive?

(a) If you drill an unsuccessful certified well, and satisfy the administrative requirements of § 203.46, you will receive a royalty suspension supplement of five (5) (*Note: Added for clarity.*) BCF for your lease, to be applied to subsequent production of gas and oil, as reported in accordance with 30 CFR Part 216.53 (OGOR-A), on or allocated to your lease as provided in § 203.45. The conversion from oil to gas for using the royalty suspension supplement is specified in § 203.73.

(b) You may receive royalty suspension supplements for up to two unsuccessful certified wells per lease. You may not receive more than one royalty suspension supplement from a single well bore.

(c)(1) If the same well bore used to qualify for a royalty suspension supplement later produces from a perforated interval the top of which is 15,000 feet TVD SS or deeper no later than March 26, 2003, it will become a successful qualified deep well. If the completion of this successful qualified deep well is on your lease, then you must subtract that portion of the royalty suspension supplement that has been applied to other production from the lease from the royalty suspension volume remaining for the lease. The difference represents the maximum royalty suspension volume for which you are eligible on the lease. ~~If the completion of this successful qualified deep well is on another lease, then the royalty suspension volume earned by this other lease must be reduced by the full amount of the royalty suspension supplement applied on your lease.~~ (*Note: Suggest this sentence be deleted as it is inconsistent with the rest of the rule. Royalty relief and supplement are being applied on a lease bases throughout the rule. This*

sentence states that a completion of a well on another lease would require reducing the royalty suspension volume on your lease where the completion was not made.) You may not use any remaining unused portion of the royalty suspension supplement earned for that well bore. (2) Notwithstanding any other provision of this part, the total amount of royalty relief earned from or applied to production from a single well bore that originally qualified as an unsuccessful certified well, but that later produces, cannot exceed 25 BCF.

(d) You must pay minimum royalties in accordance with your lease terms notwithstanding any royalty suspension supplements under this section.

§ 203.45 To which production do I apply the royalty suspension supplements from drilling one or two unsuccessful certified wells on my lease?

(a) Subject to the requirements of §§ 203.40, 203.42, 203.44, and 203.47 and beginning the first day of the month that you file the data and written (Note: Added for clarification.) request under § 203.46, you must apply royalty suspension supplements stipulated in § 203.44 to production from, or allocated under an approved unit agreement to, the lease that was the target of your drilling, without restriction on the drilling depth of the well producing the gas or oil.

(b) If you have a royalty suspension volume for the lease under § 203.41, you must exhaust the royalty suspension volume before applying any unused royalty suspension supplement to deep gas production.

(c) If you have no production on which to apply the royalty suspension supplement allowed under § 203.44 when it is earned, your royalty suspension supplement applies to the earliest subsequent production on your lease. Unused royalty suspension supplements automatically (Note: Added for clarification and to let lessees know no action is required to transfer the unused volumes.) transfer to a successor lessee and expire with the lease.

(d) You may not apply the royalty suspension supplement allowed under § 203.44 to production from any other lease, except for production allocated to your lease from an approved unit agreement. If the unsuccessful certified well is on a lease subject to an MMS-approved unit agreement, the lessees of other leases in the unit may not use any portion of your royalty suspension supplement.

(e) You must begin or resume paying royalties when cumulative oil and gas production from or allocated to your lease (excluding any deep gas produced subject to a royalty suspension volume allowed under § 203.41) reaches the applicable royalty suspension supplement. For the month in which the cumulative production reaches this royalty suspension supplement, you owe royalties on the portion of gas or oil production that exceeds the amount of the royalty suspension supplement remaining at the beginning of that month.

(f) If there is more than one lessee on a lease reporting production on the OGOR-A, and subject to the notice requirements under § 203.43 and § 203.46, production first reported and recorded by MMS will be the royalty supplement counted first in reaching the total royalty supplement the lease is entitled to receive. (Note: This sentence is suggested to cover the contingency of multiple operators on a lease reported production from different platforms and reservoirs. This will assist in administering the royalty supplement between different operators.)

§ 203.46 What administrative steps must I take to obtain and use the royalty suspension supplement?

- (a) Before a deep well targeted to a reservoir on your lease commences drilling, you must notify, in writing, the MMS Regional Supervisor for Production and Development of your intent to begin drilling operations; and
- (b) After drilling the well you must:

(1) Provide MMS with data, including any well test data, that allows MMS to confirm that you drilled an unsuccessful certified well as defined under § 203.0. You must submit this data within 60 days after reaching the Total Depth (TD) in your well to be eligible for the royalty suspension supplement under §203.45; and

(2) Request confirmation that the royalty suspension supplement applies to your lease.

(c) If you commenced drilling an unsuccessful certified well after March 26, 2003 and finished it before **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]**, you must provide the information required by paragraph (b) on or after **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]** and no later than **[INSERT THE DATE 60 DAYS AFTER THE EFFECTIVE DATE OF THE FINAL RULE]**.

(d) Should you fail to provide timely notice as provided under this § 203.46, MMS will have the discretion to deny your request for a royalty suspension supplement. (Note: Added to eliminate any confusion as to what would happen should a lessee fail to timely notify MMS of a pending deep gas well test.)

§ 203.47 [Removed]

§ 203.487 May I substitute the deep gas drilling provisions in § 203.0 and §§ 203.40 through 203.476 for the deep gas royalty relief provided in my lease terms?

(a) You may exercise an option to replace the applicable lease terms for relief related to deep gas drilling with those in §203.0 and §§ 203.40 through 203.46 if you have a lease issued:

(1) From a lease sale held after January 1, 2001, and before **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]**; and

(2) Wholly west of 87 degrees, 30 minutes West longitude in the Gulf of Mexico ~~entirely~~ any portion of which is located *(Note: The word "entirely" was deleted, and the new phrase added to include all leases where any portion of the block is in water depths of 200 meters. Adding this language will allow a few additional leases in the Gulf of Mexico to be subject to potential royalty relief for deep gas drilling. We consider this beneficial and should be included as part of the area being considered for incentives.)* in water less than 200 meters deep, with royalty relief provisions for deep gas drilling.

(b) You may exercise this option by notifying the MMS Regional Supervisor for Production and Development of your decision before **[INSERT THE DATE 180 DAYS AFTER THE EFFECTIVE DATE OF THE FINAL RULE]** and specifying the lease and block number.

(c) Once the option is exercised, you must meet all the activity and administrative requirements pertaining to royalty relief for leases eligible for deep gas royalty relief that were issued in an OCS lease sale held before January 1, 2001.

(d) Exercising the option under paragraph (a) of this section is irrevocable. If you do not exercise this option, your original lease terms apply.